IT 02-0002-GIL 01/11/2002 SUBTRACTION MODIFICATIONS - OTHER RULINGS

General Information Letter: Only certain Illinois bonds are exempt from Illinois income taxation.

January 11, 2002

Dear:

This is in response to your letter dated December 13, 2001 in which you request answers to a survey on Illinois taxation of municipal bonds. According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill.Adm.Code §1200, or on our website http://www.revenue.state.il.us/legalinformation/regs/part1200.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics.

In your letter you stated:

> We are currently reviewing your state's tax treatment of municipal bond income for the 2002 tax year. We collect this data annually for the benefit of COMPANY clients who are residents of your state. While we realize your state's tax laws could change during the course of the year, we intend to publish available data by March 1, 2002. Therefore, we would appreciate a response by February 15 with the **best current available information** for the 2002 tax year. If 2002 information is not yet available, please provide information on currently effective tax law. Please inform us of the following:
>
> 1) How does your state account for federal and state tax deductibility on federal and state income tax returns? (circle one)
>
> a) **One-way deductible** – The only deduction available to taxpayers is the deduction of state and local taxes paid from the federal income tax base.
>
> b) **Cross-deductible** – Taxpayers deduct state and local taxes paid from federal tax base and also deduct federal taxes paid from state income tax base.
>
> c) **Cross-deductible with add-back** – Same as cross-deductible, but also requires the taxpayer to add-back to his or her state income tax base all state and local taxes paid which were deducted from federal taxable income.
>
> d) **Piggyback tax** – Taxpayers deduct state and local taxes from federal taxable income as in the one-way deductible method. However, the state income tax is a percentage of the federal tax liability.
>
> e) **Double-deductible** – Taxpayers deduct state taxes paid from federal taxable income and also from the state income tax base.
>
> f) **No state tax** – At this time this state does not levy a state income tax.

g) **Other** – Please explain the method your state uses to calculate an effective state tax rate.

Answer: g) Illinois does not allow for the subtraction of federal taxes and requires the adding back of Illinois income taxes subtracted from federal adjusted gross income.

2) Does your state tax municipal bond income on out-of-state municipal bonds? Yes or No (circle one)

Answer: Yes, these sums are added back to adjusted gross income by §203(a)(2)(A), which states:

(A) An amount equal to all amounts paid or accrued to the taxpayer as interest or dividends during the taxable year to the extent excluded from gross income in the computation of adjusted gross income, except stock dividends of qualified public utilities described in Section 305(e) of the Internal Revenue Code

3) Does your state tax municipal bond income on in-state municipal bonds? Yes or No (circle one)

If the income from only certain municipal bonds is exempt from state taxation, please include the section of your state tax code that lists those bonds which are state tax exempt.

Answer: The Illinois Income Tax Act ("IITA") allows for the subtraction from adjusted gross income of certain sources. Section 203(a)(N) states:

(N) An amount equal to all amounts included in such total which are exempt from taxation by this State either by reason of its statutes or Constitution or by reason of the Constitution, treaties or statutes of the United States; provided that, in the case of any statute of this State that exempts income derived from bonds or other obligations from the tax imposed under this Act, the amount exempted shall be the interest net of bond premium amortization;

Accordingly, if authorized by statute or the Constitution, bonds may be exempt from the Illinois income tax. Publication 101 (copy enclosed) lists the bonds currently excludable from income.

4) Are intangible taxes levied in your state on in-state municipal bonds? Yes or No (circle one)

If yes, is there an exempted amount?

Are intangible taxes levied in your state on out-of-state municipal bonds?

If Yes, is there an exempted amount?

If so, please send all the pertinent information relating to intangible taxes in your state.

Answer: Article IX, section 5(b) of the Illinois Constitution forbids ad valorum personal property taxes. Therefore, Illinois does not impose intangible taxes on either in-state or out-of-state municipal bonds.

5) Please complete or attach the current rate(s) of taxation and include the graduated income levels if applicable, for the 2002 tax year.

Answer: Article IX, section 3(a) of the Illinois Constitution forbids a graduated income tax.

Individuals 3%
C Corporations 4.8%

In addition, certain entities pay an additional Personal Property Tax Replacement Income Tax at the following rates:

C Corporations 2.5%
S Corporations 1.5%
Trusts 1.5%
Partnerships 1.5%

6) Were there any changes to your state's tax code in 2001 or are pending for 2002 that would affect holders of municipal bonds?

Answer: None at this time.

As stated above, this is a general information letter only. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Matthew S. Crain
Staff Attorney -- Income Tax